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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

No. 520

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Petitioner-Appellant,

vs.

DIRECTOR, DIVISION OF TAX APPEALS OF DEPARTMENT OF TREASURY OF STATE OF NEW JERSEY,

Defendant-Respondent

APPEAL FROM THE SUPREME COURT OF NEW JERSEY

STATEMENT AS TO JURISDICTION

JAMES D. CARPENTER,
Counsel for Appellant.

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APPEAL FROM THE SUPREME COURT OF NEW JERSEY

STATEMENT AS TO JURISDICTION

The Judgment and Opinion Below and Statutory Provisions Sustaining Jurisdiction

This appeal, presented this 18th day of December, 1951, is from a final judgment of the Supreme Court of New Jersey, dated October 1, 1951. A copy of the opinion on which the said judgment was entered (8 N.J. Adv. Sheets 15) is annexed hereto as Appendix A. The judgmeat affirmed the assessment of franchise taxes against The Central Railroad Company of New Jersey for the years 1948, 1949 and 1950. This appeal questions the constitutionality of that portion of the New Jersey Railroad Tax

Law which provides the manner of assessing franchise taxes against a railroad system carrying on interstate operations, as that statutory provision has been applied by the Director of the Division of Taxation, and as it has been construed by the Supreme Court of New Jersey. The jurisdiction of the Supreme Court of the United States to review this case by way of direct appeal is conferred by Title 28, United States Code, § 1257(2), 62 *Stat.* 929 (1948). The following decisions sustain such jurisdiction: *Dahnke-Water Milling Co.* v. *Bondurant*, 257 U.S. 282 (1921); *Wheeling Steel Corp.* v. *Glander*, 337 U.S. 562 (1949). (Denial of equal protection through the construction and application of a statute not discriminatory on its face is reviewable on appeal.) A petition for allowance of appeal was presented to the Chief Justice of the Supreme Court of New Jersey on December 14th, 1951, and was denied.

Questions Involved

I

A New Jersey statute imposed a franchise tax at the rate of 10% on the net railway operating income, earned in New Jersey, of all railroads operating in the State. The statute was construed and applied by the tax administrator and by the State Supreme Court so as to aggregate the operating income of appellant's subsidiary, which operates a railroad only in the State of Pennsylvania, with the operating deficit of appellant, which operates a railroad in New Jersey but not in Pennsylvania, and to tax, as if earned in New Jersey, more than two-thirds of such aggregate operating income by applying a track-mile allocation formula. The fact was, as demonstrated by the operating accounts maintained by appellant pursuant to Interstate Commerce Commission requirements and under Interstate Commerce Commission supervision, that appellant had no

operating income attributable to New Jersey. Does not the statute, as so construed and applied, deny to appellant due process of law, in violation of the Fourteenth Amendment of the Constitution of the United States, and does it not impose a burden on, and discriminate against, the interstate commerce in which appellant is engaged, in violation of Article I, Section 8, Clause 3, of the Constitution of the United States, by imposing a franchise tax which demonstrably has no relation to the value of the local privilege?

II

The above-mentioned New Jersey franchise tax statute was construed and applied by the State of New Jersey so as to assess franchise taxes against railroads other than appellant by excluding from the computation of their net railway operating income earned in New Jersey the operating deficits of their subsidiary operating companies which bear to them the same relationship that appellant's abovementioned subsidiary operating in Pennsylvania bears to it. Does not such a construction of the statute deny to appellant the equal protection of the law, in violation of the Fourteenth Amendment to the Constitution of the United States?

New Jersey Statute Involved

Railroads operating in the State of New Jersey are taxed exclusively under the provisions of the Railroad Tax Law of 1948, N.J.S.A. 54:29A-1, et seq. (Supp.), P.L. 1948, Chapter 40, which amended and supplemented P.L. 1941, Chapter 291. That statute imposes certain taxes on tangible property, with which we are not concerned here. In addition, it imposes an annual excise tax upon all railroads operating within the state, for the privilege of exercising their respective franchises. Sections 2, 13 and 14, which are the pertinent ones, are set

forth verbatim in Appendix B annexed. The tax imposed is 10% of the net railway operating income earned by the railroad during the calendar year preceding the assessment. In the case of a railroad or a system operating in more than one state, the income taxable in New Jersey is to be determined by allocating to this state the same proportion of the system's net railway operating income as the total track mileage operated within the state bears to the total track mileage operated everywhere. This allocation formula is generally known and will hereinafter be referred to as the "all track miles formula".

Tax Assessments Complained Of

The franchise tax assessments complained of were for the years 1948, 1949 and 1950,[1] based respectively on net railway operating income for the years 1947, 1948 and 1949. The fact is that appellant had a deficit of net railway operating income for the year 1947 in the amount of $4,923,000.00. The State of New Jersey, however, by arbitrarily allocating to New Jersey a major portion of the net railway operating income of appellant's Pennsylvania subsidiary, assessed the tax as if appellant had had a net railway operating income of $2,132,000.00. Appellant had a deficit of net railway operating income for the year 1948 in the amount of $3,885,000.00. The State of New Jersey, however, by arbitrarily allocating to New Jersey a major portion of the net railway operating income of appellant's Pennsylvania subsidiary, assessed the tax as if

[1] The complaints and appeals for 1948 and 1949 were consolidated for trial. After the trial, the parties entered a stipulation with respect to the complaint and appeal from the assessments for the year 1950 to the effect that it involved the same law and facts as are involved in the appeals from the assessments for the years 1948 and 1949, except for the amount of money, and should, therefore, be governed and controlled by the ultimate decision both on the law and the facts in the appeals from the assessments for the years 1948 and 1949.

appellant had had a net railway operating income of $4,354,000.00. Appellant had a deficit of net railway operating income for the year 1949 in the amount of $4,667,000.00. The State of New Jersey, however, by arbitrarily allocating to New Jersey a major portion of the net railway operating income of appellant's Pennsylvania subsidiary, assessed the tax as if appellant had had a net railway operating income of $2,545,000.00. For each of these years, and for the year 1950, the tax should have been the statutory minimum of $4,000.00. The taxes actually assessed were: for 1948, $213,000.00; for 1949, $435,000.00, and for 1950, $254,000.00, a total of $902,000.00.

Nature of the Case

The Central Railroad of New Jersey is a Class I interstate railroad. Prior to 1946, it operated its present properties, which are located within the States of New Jersey and New York, and also operated certain properties located in the State of Pennsylvania. The Pennsylvania property was known as the Lehigh and Susquehanna Division of the Central Railroad, and was held under a lease from the Lehigh Coal and Navigation Company. While appellant's properties were being operated by trustees in reorganization, under the supervision of the United States District Court for New Jersey, it was determined by the trustees that it would be advantageous to vest the Pennsylvania properties in a wholly owned subsidiary, and for that subsidiary to operate the Pennsylvania lines rather than to have them operated by appellant (132a-26 to 134a-28; 136a-1).[2] This plan for segregation and separate operation of the Pennsylvania

[2] All references are to the Appendix and Supplemental Appendix of the appellant, which were before the Supreme Court of New Jersey, and which are certified herewith by the Clerk of that Court.

lines was approved by the United States District Court (Ex. CR-6, 213a) and by the Interstate Commerce Commission (Ex. CR-8, 232a). The plan contemplated that, although affiliated, the new corporation should maintain a separate organization and should have the same relationship to appellant, as regards transportation service, as would any other independent connecting road (157a-4 to 25; 165a-30 to 166a-19).

The separation actually occurred on August 5, 1946. The appellant had for many years owned all the stock of a small railroad corporation in Pennsylvania, by name, Easton & Western Railroad. The name of this Railroad was changed to Central Railroad Company of Pennsylvania (Ex. CR-8, 231a-22).[3] The trustees subleased to CRP all of the properties in Pennsylvania which had been leased from the Lehigh Coal and Navigation Co., and the trustees purchased a block of stock from CRP for cash, in order to give CRP working capital (Ex. CR-5, 192a). They also sold or leased to CRP sufficient locomotives, rolling stock and other property to set it up as a fully integrated and completely equipped independent railroad (Ex. CR-20, 335a; 156a-12 to 30). CNJ and CRP had the same chief executive officers, but from division superintendents down, each railroad is separate and distinct from the other (156a-30 to 40). CRP has its own employees and operates its own lines of railroad, which are wholly within the State of Pennsylvania (Map from Ex. CR-33, 353a).

CRP, from and after August 5, 1946, the date of separation, has maintained its own separate books of account (80a-3 to 19); it has its own timetables, and annually has

[3] For convenience, hereinafter the appellant, Central Railroad Company of New Jersey, will be referred to as CNJ, and its subsidiary, Central Railroad Company of Pennsylvania, will be referred to as CRP.

filed its Form A Reports with the Interstate Commerce Commission, as required of every Class I railroad (Ex. CR-13 and 14, 287a to 311a). CNJ also files its own Form A Reports, as required of it as a Class I railroad (Ex. CR-10 and 11, 263a to 286a).

The accounting forms used by the two railroads are separate and distinct from each other (92a-35 to 100a-33), and, stating it briefly, the two railroads operate as separately and distinctly as any two other Class I railroads whose lines happen to connect.

In accordance with the prevailing practice of other separately operated railroads which engage in through train operations, all train operations, both freight and passenger, on the CRP are under the control of CRP, and CNJ has no jurisdiction whatsoever over either the crews in local service of the CRP, or through joint service, so long as the crews are on the tracks of the CRP (164a-28 to 35). Whenever a joint through train operating on the CRP, and pulled by a CRP locomotive, and operated by a CRP crew, passes the state line junction on the Delaware River, the crew comes under the jurisdiction of the CNJ (164a-36), and vice versa. The road on which the foreign crew is operating reimburses the foreign road for the crew's wages and for the use of the foreign locomotive (88a-20 to 35; 111a-30 to 112a-20). At the time of the hearing, the CRP had 1,780 employees on its payroll, most of whom perform all of their services exclusively on the property of the CRP and at no time do any work on the CNJ, the only exception being those few crews who operate trains in joint service on the two roads (163a-30 to 40). Out of a daily average of approximately 78 train crews employed by CRP, only about 13 operate through and over the tracks of the CNJ in joint through service (162a-33 to 163a-18).

In the case of joint through freight shipments, the two lines share the revenue in accordance with division of revenue schedules, which were published at the time of separation (Ex. CR-20, 348a). These divisions were based upon existing divisions between CNJ and carriers other than CRP with which it connects at Philipsburg, New Jersey; and upon a careful study of divisions in effect between other and independent carriers which roughly parallel the lines of CNJ and CRP (136a-15 to 138a-25). The ICC found specifically that the divisions were prima facia fair and in accordance with general practices in the territory (Ex. CR-8, 255a-10 to 30). The divisions had to be fair and adequate, in order to secure the consent of the Lehigh Coal and Navigation Co. to the sublease. Had the Lehigh Coal and Navigation been required to take back the Pennsylvania properties because of the disaffirmance of, or default upon, the lease by the reorganization trustees of CNJ, divisions unduly generous to CRP would have hurt the lessor, since connecting lines would prefer to route through shipments over competing carriers receiving a smaller proportion of joint through revenue (139a-13 to 140a-10).

The operating accounts that are maintained separately by these two railroads are maintained in the greatest of detail, as required by the ICC. Each railroad is required to complete a schedule designated "300.1, Income Account for the Year" (264a, 276a, 288a and 301a), in which it is required to set forth the balances taken from fifteen separate major operating accounts, including Account No. 501, "Railway Operating Revenues", and Account No. 531, "Railway Operating Expenses".

Account No. 501 "Railway Operating Revenues", is, in turn, based upon a schedule in the Form A Report designated "310. Railway Operating Revenues", and this Schedule 310 requires the railroad to set forth the balances from

twenty-eight separate underlying operating revenue accounts.

Account No. 531, "Railway Operating Expenses", is, in turn, based upon a schedule in the Form A Report designated "320. Railway Operating Expenses", and this schedule requires the railroad to set forth the balances from 142 separate underlying operating expense accounts.

These underlying operating revenue accounts and operating expense accounts are necessarily based upon literally hundreds of thousands of separate operating transactions which each railroad records in its own operating books and records. Unless each of the two roads in question had maintained detailed acounts, recording the results of their respective operations, it would have been impossible for them to have filed their respective Form A Reports.

Appellant has shown in great detail the nature of the separate operation of the two railroads, and the nature and accuracy of their separate operating accounts, because appellant's case rests ultimately upon the proposition that the franchise tax payable to the State of New Jersey by CNJ should have been based upon that railroad's net railway operating income as determined from its own operating accounts. It is appellant's contention, in view of the precise determination of net railway operating income earned in the State of New Jersey resulting from the maintenance of these accounts, that the statute, as construed and applied by the assessing officials and by the courts of New Jersey, requiring the franchise tax base to be determined by aggregating the reported net railway operating incomes of CNJ and CRP and then allocating a fraction (67%) to New Jersey on the all-track-mileage formula constitutes a violation of the Constitution of the United States.

Appellant contends that the use of a track-mileage formula rather than the operating accounts maintained by the taxpayer for the purpose of determining the income of

CNJ subject to the franchise tax is a violation of the Commerce Clause and of the Due Process Clause, and that the Supreme Court of New Jersey has indulged a statutory construction which denies to appellant the equal protection of the law.

The Railroad Tax Law of the State of New Jersey contains a very precise definition of what is a railroad system. That definition is contained in N.J.S.A. 54:29A-2, P.L. 1948, Chapter 40, §2, and reads as follows:

> " 'System' means any independently operating railroad which operates its facilities and those of one or more other railroads as a single utility for furnishing transportation service. A system shall include all companies the property of which is so operated either by virtue of control through direct or indirect ownership of a majority or more of capital stock, or under lease, trackage rights or under any other form of contract, and for which separate operating accounts are not maintained."

It was appellant's contention below that the maintenance by it and its subsidiary of separate operating accounts exempted the two roads from being treated as a single system, and that, therefore, the only possible basis for taxation of CNJ was its own operating accounts. The Supreme Court of New Jersey, however, held that the statute did not mean to exclude railroads from system treatment merely on the basis of the maintenance of separate operating accounts, but instead, required that all roads which, in fact, were affiliated, and in fact provided an integrated transportation service to the public, were to be treated as a system and were to be taxed under the allocation formula rather than on the basis of their separate operating accounts, which accurately show the income earned in New Jersey and properly subject to taxation by New Jersey.

This construction of the State statute is, of course, not

reviewable here upon its merits. The ruling of the Court, however, was made after the appellant had called to the Court's attention the fact that other groups of railroads, whose operating relationships were identical to the operating relationships subsisting between the CNJ and the CRP, were not taxed as systems, but instead were taxed on the basis of the separate operating accounts of the component roads; and that the apparent inconsistency in the tax treatment of the CNJ-CRP group and other similarly situated railroad groups was explicable only upon the basis that the statute was being construed by the taxing authorities with no other purpose or guide than the maximization of revenue. In other words, appellant claimed before the Supreme Court of New Jersey that the construction of the statute which the Supreme Court ultimately adopted in this case had the effect of discriminating against the appellant. This claim is an additional reason for a thorough analysis of the operating relationships between CNJ and CRP, so that the Court may compare this situation with the situation of other railroads which were exempted from taxation on a system basis. The facts concerning these other carriers are fully stated *infra*, in connection with the proof that the questions presented are substantial.

Manner in Which Federal Questions Were Raised

The constitutional questions were first raised at the earliest possible time—namely, in the appeals from the action of the assessing officials to the quasi-judicial Division of Tax Appeals. All three Complaints and Appeals here involved were substantially identical, and we quote from only one of them, that taken from the assessment for 1948:

> "5. Chapter 291, P. L. 1941, as amended and supplemented, as applied and construed by the Acting Director, Division of Taxation, in the assessment herein

complained of violates the Constitution of the United States for the following reasons:

"(a) It imposes upon your appellant a New Jersey franchise tax measured not by the net railway operating income of your appellant but by net railway operating income which is in fact net railway operating income derived from the operation of a railroad wholly without the State of New Jersey and which is engaged in the transportation of persons and property in interstate commerce. Such tax constitutes an undue burden and discriminates against the interstate commerce in which appellant is engaged, all in violation of Art. 1, Section 8, Clause 3 of the Constitution of the United States.

"(b) It imposes upon your appellant a New Jersey franchise tax measured not by the net railway operating income of your appellant but by net railway operating income which is in fact net railway operating income derived from the operation of a railroad wholly without the State of New Jersey, and whose operations are conducted by Central Railroad Company of Pennsylvania, a corporation organized under the laws of the State of Pennsylvania. Such tax, imposed upon earnings and operations which are beyond the jurisdiction of the State of New Jersey, deprives your appellant of property without due process of law in violation of Section 1 of the Fourteenth Amendment to the Constitution of the United States.

"(c) It imposes upon your appellant a New Jersey franchise tax which unjustly and unreasonably discriminates against your appellant compared with other railroad companies operating in the State of New Jersey. Such tax denies your appellant the equal protection of the laws in violation of Section 1 of the Fourteenth Amendment to the Constitution of the United States." (4a-10 to 5a-20)

The Division of Tax Appeals decided the case adversely to appellant and a further appeal was taken to the Appellate Division of the Superior Court of New Jersey. Under New

Jersey practice, the entire record went up, and, of course, the constitutional points were before the Court. Before the case was heard in the Appellate Division, the Supreme Court of New Jersey, under its discretionary jurisdiction, certified the case for hearing and determination before itself. Under New Jersey practice, the record as it stood in the Appellate Division became the record in the Supreme Court. Therefore, the federal questions were duly presented to the Supreme Court. That this case was presented to, and decided by, the Supreme Court of New Jersey as one where the validity of a state statute was drawn into question on the ground of its being repugnant to the Constitution of the United States may be seen from the following quotation from the opinion below:

> "The appellant says the statute as construed and applied by the Division of Tax Appeals violates the commerce clause and the equal protection and due process clauses of the 14th Amendment of the Federal Constitution. * * *"

The Federal Questions Are Substantial

The ultimate federal questions presented are three-fold. The first is whether or not the construction placed upon the statute denied to appellant due process of law, in that the State of New Jersey assessed taxes against appellant by allocating to itself net railway operating income which was not derived from the exercise of any franchise enjoyed under the State of New Jersey, but, on the contrary, demonstrably arose solely from the operations of appellant's subsidiary, CRP, wholly within the State of Pennsylvania. The second question is whether or not the construction placed upon the statute imposes a burden on interstate commerce in that the uncontradicted evidence clearly shows that all New Jersey operations are carried out at a tremendous loss, and that the profit enjoyed by the CNJ sys-

tem arises exclusively from interstate transportation which is beyond the power of the State of New Jersey to regulate. The first and second questions are based upon the fact that the analytical ICC accounts of CNJ and CRP present an accurate statement of costs and revenues fairly allocable to the political sub-divisions involved, and that the application of the all-track-mile formula in disregard of these accurate records is arbitrary. The third is whether, in so construing the statute as to treat CNJ and CRP as a single system for tax purposes, the taxing authorities and the Division of Tax Appeals have not established irrational and arbitrary classifications. Evidence was introduced which proved that other groups of carriers having the same intercorporate and transportation relationships as CNJ does with CRP were not treated as systems, and that this difference in tax treatment was apparently based on the fact that if they had been treated as systems the amount of the New Jersey Franchise Excise Tax assessable against them would have been diminished. In the case at bar, of course, the amount of franchise tax assessable was increased by treating CNJ and CRP as a system.

A. Due Process of Law

The separate operating accounts which are maintained by CNJ and CRP, under the supervision and according to the requirements of the Interstate Commerce Commission, are accurate revenue and costs records which reflect the respective results of operations within New Jersey and Pennsylvania.

Your appellant recognizes that the State of New Jersey has the right to reach not only the intrastate income of a railroad, but also such portion of the interstate income as may reasonably be attributed to activities carried on or facilities maintained within the State. The separate operating accounts filed with the Interstate Commerce Commis-

sion by the two railroads, however, give full measure of weight to the income-producing capacity of the Jersey properties and activities, and account therefor more accurately than any formula possibly could.

This can be very simply shown by an analysis of first the gross revenue figures, and then the figures for operating expenses. Taking, for example, the year ended December 31, 1947, it appears that CNJ had gross operating revenues of roughly $37,500,000.00 (Exhibit CR-10, 264a). In the same year, CRP had gross railway operating revenues of approximately $18,200,000.00 (Exhibit CR-13, 288a), for a combined total of $55,700,000.00. Thus, the railroads' own accounts, *including the results of their division of joint through revenues*, attribute 67% of the gross income to the State of New Jersey. This is exactly the allocation percentage which the State seeks to apply under the all-track mileage formula (8a-30 to 35).

We turn then to the question of operating expenses. For the CNJ, these total, during the year 1947, approximately $34,165,000.00 (Ex. CR-10, 264a). Of that amount, approximately $13,150,000.00 is chargeable to passenger operations (Ex. CR-10, 273a and 274a), which are conducted at a terrific loss ($9,223,000.00 in 1948, and $8,717,000.00 in 1949 (146a-11, 147a-23)). The overwhelming bulk of the CNJ's passenger business is purely commuter traffic intrastate (145a-35 to 146a-10). Therefore, there can be no claim made by the State of New Jersey that the operating accounts attribute to New Jersey expenses of passenger operation which are properly chargeable to Pennsylvania.

It should further be noted that one of the charges allowable against railway operating income, in determining the *net* railway operating income for franchise tax purposes, is the item of taxation. CNJ pays, in common with other railroads in New Jersey, a very heavy tax upon its tangible property. The tax accruals of CNJ during 1947, which

affected the tax base for the year 1948, were $4,864,000.00 (264a-6)—more than enough to wipe out the operating profit of $3,399,000.00, which CNJ enjoyed prior to tax accruals (264a-5). The same is true for the tax base year 1948, when the operating profit before tax accruals was $4,513,000.00 (276a-5), and the tax accruals were $4,705,000.00 (276a-6). This is the explanation of why CNJ shows an operating loss. The loss has nothing to do with "bookkeeping legerdemain", as charged below.

The Attorney General of New Jersey, however, contended that the division of joint through freight revenues between the CNJ and the CRP is unduly generous to CRP. The record, however, shows that the divisions are in line with the divisions generally obtaining between all the railroads in this territory, and that adherence to the prevailing practices was necessary in order to satisfy Lehigh Coal and Navigation, the lessor of the Pennsylvania properties, of their fairness (136a-15 to 138a-25; 139a-13 to 140a-10). The record further shows that application has been made to the ICC for permission to increase the proportion payable to CNJ, but that such efforts have been unsuccessful (165a-10 to 30).

That the operating accounts and divisions of revenue between CNJ and CRP are fair, honest and accurate, and are not rigged in favor of CRP, as charged by the State, but without support of any facts, is further clearly demonstrated by the fact that the operating ratio of CRP is just as high as the operating ratio of the Lehigh and New England 359a-4 to 360a-38; Ex. CR-39, 363a), a coal carrying road which is roughly parallel to and operates under substantially the same conditions as CRP (353a). If the divisions were rigged, CRP's operating ratio would obviously be much lower than that of the similarly situated Lehigh and New England.

It is respectfully submitted that this case should be ruled

by *Southern Railway Co.* v. *Kentucky*, 274 U. S. 76 (1927), where this Court struck down as unconstitutional a franchise tax assessment made against Southern Railway by virtue of the activities carried on in Kentucky by a wholly owned but separately operated subsidiary. A tax was imposed upon the franchise value, which was determined by capitalizing the net railway operating income of the system, allocating the capitalized value to Kentucky on a mileage basis, and deducting from the allocated share the value of tangible property otherwise taxed within the Commonwealth. Several of Southern's subsidiaries within Kentucky were permitted to report separately for franchise tax purposes, and the controverted assessment was made only by reason of the activities, and the alleged apportioned franchise value, of the corporation named "Southern Railway in Kentucky". The lines of that subsidiary showed a record of per mile operating income much lower than that of the system as a whole, and, in fact, the subsidiary's lines ordinarily operated at a loss. However, computing the franchise value on a system basis gave a franchise value of from $13,000.00 to $23,000.00 per mile for the subsidiary. In striking down the tax, this Court said:

> "* * * If taken separately it is clear that, because of lack of net earnings no substantial intangible elements of value could reasonably be attributed to the railroad of that company. * * * The mere statement of the figures is sufficient to show that the amount added as a basis for franchise taxes is so excessive and unreasonable that it cannot be sustained; and such an application of the system earnings amounts to an attempt to tax property outside the state. And as the direct earnings per mile of the lines of that company are so much less than the average for the system, it is plain that the amount adjudged to have been omitted was arbitrarily excessive and included values of system property beyond the limits of Kentucky."

Similarly, this case should be ruled by *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U. S. 123 (1931), and by the principle enunciated in *Norfolk and Western Railway Co.* v. *North Carolina*, 297 U. S. 682 (1936), that a track mileage formula cannot constitutionally be used in any case where there is demonstrably no relationship between mileage and income. This is such a case.

B. Commerce Clause

The Supreme Court of New Jersey has erred in holding that the franchise tax as levied upon the earnings of The Central Railroad Company of New Jersey is not an unreasonable burden upon interstate commerce. This Court has always looked beyond form and given due regard to substance. It has always held unconstitutional a tax which in operation and practical effect imposed a levy for the privilege of carrying on interstate commerce, notwithstanding the characterization which the state court may have chosen to apply to the tax. *International Paper Co.* v. *Massachusetts*, 246 U. S. 135 (1918); *New Jersey Bell Telephone Co.* v. *Board of Taxes*, 280 U. S. 338 (1930); *cf. Spector Motor Service, Inc.* v. *O'Connor*, 340 U. S. 602 (1951).

The Form A Reports filed by CNJ with the Interstate Commerce Commission show that, upon any analytically sound basis, CNJ loses money. This being so, the tax base used by the Director of the Division of Taxation, is an attempt to measure the value of a local privilege by income derived wholly from interstate transportation, carried out by CNJ and CRP in cooperation, which has no relationship whatsoever to the value of the local franchise. As construed and applied below, the statute, in its practical effect, seeks to make the doing of a purely interstate and constitutionally protected transportation business in the State of Pennsylvania taxable by the State of New Jersey.

That the Railroad Franchise Tax Act, as construed and applied below, runs afoul of the Commerce Clause is also demonstrated by reference to another series of cases in this Court. It has always been the law that even a constitutionally permissible tax measured by the receipts from, or imposed on the instrumentalities of, interstate commerce must be held invalid when the measure of the tax is such as to subject commerce among the states to cumulative burdens which are not, and in the nature of the case cannot be, equally imposed upon purely local operations. *Union Tank Line Co.* v. *Wright*, 249 U. S. 275 (1919); *Wallace* v. *Hines*, 253 U. S. 66 (1920); *Adams Mfg. Co.* v. *Storen*, 304 U. S. 307 (1938); *Gwin, White & Prince, Inc.* v. *Henneford*, 305 U. S. 434 (1939).

As was said by Mr. Justice Stone in *Gwin, White & Prince:*

> "Here the tax, measured by the entire volume of the interstate commerce in which appellant participates, is not apportioned to its activities within the state. If Washington is free to exact such a tax, other states to which the commerce extends may with equal right lay a tax similarly measured for the privilege of conducting within their respective territorial limits the activities there which contribute to the service. The present tax, though nominally local, thus in its practical operation discriminates against the interstate commerce, since it imposes upon it, merely because interstate commerce is being done, the risk of a multiple burden to which local commerce is not exposed."

This principle was recently reiterated in *Central Greyhound Lines* v. *Mealey*, 334 U. S. 653 (1948).

The formula as here applied results in attributing to New Jersey a far larger portion of the combined CNJ-CRP operating income than the activities and facilities within the state can reasonably justify. And, as in the *Adams*,

Gwin and *Greyhound* cases, the statutory construction adopted below is one which is capable of subjecting commerce among the states to a multiple burden.[4] While the attorneys for the state maintain the appropriateness of the New Jersey formula, they cannot deny that the State of Pennsylvania also has full constitutional power to impose a tax upon the entire net railway operating income of CRP. That entire income is fairly apportionable to that state, because it is actually earned there. If Pennsylvania were so to tax, the result would be a cumulative burden upon the proceeds of interstate commerce—a burden which would not be felt if CNJ were to interchange freight at state line junction with, for example, the Lehigh Valley instead of CRP. The effect of the decision below is to make interstate transportation by railroad subject to a multiple burden whenever, in the judgment of New Jersey's taxing authorities, the interchanging roads are so allied by stock control or operating contracts as to constitute a system. Whatever respondents may say concerning the reality of CNJ's control over CRP, they can never be allowed to predicate upon that control the imposition of multiple and discriminatory burdens upon receipts from interstate commerce.

C. Equal Protection of the Laws

The State's expert, Charles E. Barnes, who calculated the franchise tax on the various railroads doing business in the State from their Form A Reports, and made out the assessment, testified that, in assessing the franchise tax against the Pennsylvania Railroad Company, he did not include in its revenue the revenues of the Long Island Rail-

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[4] The statutory construction adopted below has the effect also of depriving the Federal Government of taxes, since all taxes improperly assessed by the State of New Jersey are deducted by the railroad in computing its net income subject to the federal income tax.

road (173a-38 to 174a-5). The principal general officers of the Pennsylvania Railroad and the Long Island Railroad were virtually identical in the years here involved (Ex. CR-41, 356a; Ex. CR-42, 357a). Mr. Barnes admitted that the stock of the Long Island was owned one hundred percent by The Pennsylvania Railroad Company (174a-5 to 10), and that the accounting of the Long Island was performed in Philadelphia, and many of the other functions were performed in Philadelphia, in the general offices of the Pennsylvania Railroad (176a-4 to 20). There was also evidence that the expenses of the joint officers and so forth are prorated as between the Pennsylvania Railroad and the Long Island, just as they were prorated between the CNJ and CRP (154a-30 to 40).

Mr. Barnes maintained, nonetheless, that the Long Island was operated separately from the Pennsylvania, and that since the Pennsylvania and Long Island each filed separate Form A Reports, he did not assess the earnings of the Long Island with the Pennsylvania.

It is interesting to note, however, that this Court has held that the Long Island and the Pennsylvania operate some properties jointly. The lines of the Long Island end at Sunnyside, and the Long Island reaches Penn Station by trackage rights over the Pennsylvania Railroad's East River Tunnels. In holding such trackage rights subject to regulation by the Interstate Commerce Commission, this Court found that the Long Island and the Pennsylvania jointly operated the tunnels and other terminal facilities. *Transit Commission* v. *United States*, 289 U. S. 121 (1933). Accordingly, there can be no difference between the situation that existed between the Pennsylvania Railroad and the Long Island Railroad Company for 1947 and 1948, and the situation between The Central Railroad Company of New Jersey and The Central Railroad Company of Penn-

sylvania. From an assessing standpoint, however, it was to the advantage of the State to include the earnings of The Central Railroad Company of Pennsylvania in the earnings of the CNJ, and to exclude the deficits of the Long Island from the net operating profit of the Pennsylvania. Exhibit CR-40, 355a, shows the operating revenues, operating expenses and net railway operating income for the Long Island Company for 1947 and 1948, from which it appears that the Long Island had a deficit in net railway operating income for 1947 of $2,193,000.00, and for 1948, a deficit of $4,233,000.00. If those deficits had been included or charged against the net railway operating income of the Pennsylvania, the State would then have received less in franchise taxes from the Pennsylvania Railroad.

Furthermore, Mr. Barnes was asked if he knew any other railroads in the State whose stock is owned by the parent and has common officers, which he did not assess as part of the system of the parent. He said:

> "Well, off-hand, I can think of none other than the Penn-Reading Seashore Lines where you have joint ownership of the major roads" (175a-13 to 16).

Mr. Barnes testified that the earnings of the Penn-Reading Seashore Lines were not assessed to either parent, either the Pennsylvania Railroad or the Reading Railroad Company (175a-17 to 20).

The Pennsylvania-Reading Seashore Lines is owned 66⅔% by the Pennsylvania Railroad Company. *Unification of Lines in Southern New Jersey*, 193 I. C. C. 183 (1933). In origin and operating relationships, the Pennsylvania and the Penn-Reading are startlingly similar to the CNJ and the CRP. Prior to 1933, Southern New Jersey was served by two railroads, one a subsidiary of the Reading, and the other a subsidiary of the Pennsylvania. In 1933, the two companies agreed upon a consolidation of the South

Jersey roads into the Penn-Reading Seashore Lines. Accordingly, the Reading transferred part of the stock of its subsidiary, Atlantic City Railroad Company, to the Pennsylvania, and the Pennsylvania caused the assignment of the 999-year lease on its subsidiary's property to Atlantic (364a-4 to 366a-40). Atlantic changed its name to "Pennsylvania-Reading Seashore Lines" after consummation of the merger, as contemplated by the agreement between the parent companies (377a-20 to 25).

Under the operating agreement, the following points of similarity to the CNJ-CRP setup appear: Although the Penn-Reading Seashore Lines are technically separately operated, nonetheless, the obligation on its leased property is jointly guaranteed by the Reading and by the Pennsylvania (366a-20 to 40). The directors of the subsidiary are the nominees of its parents (367a-30 to 35), and each parent is given sole control in appointing the operating heads of certain of the departments of the subsidiary (368a-13 to 18). Traffic matters are to be handled by the traffic officers of the parents (368a-19 to 21), and no large purchases of materials or supplies may be effected without their consent (368a-25 to 30). No existing route or channel of trade may be discontinued without their consent (368a-35 to 369a-6). There are provisions for the joint use of freight and passenger terminals and the apportionment of costs (370a-20 to 371a-20), and for the maintenance of joint through service (371a-25 to 372a-12). Finally, there are the very important factors that the divisions of joint through rates with outside roads are to be fixed by agreement between the parents (372a-25 to 35), and that the equipment used by the subsidiary is to be leased from the Pennsylvania Railroad (373a-18 to 27). All of these provisions are, in their substance, identical with the provisions subsisting in the lease and operating agreement between CNJ and CRP, and one

might reasonably suppose that the Penn-Reading Seashore Lines would be treated as a part of the Pennsylvania system, its principal parent, for franchise tax purposes. Nonetheless, Mr. Barnes testified that such is not the case, because Penn-Reading Seashore Lines filed its own Form A Report, just as CRP did.

The reason is quite evident. Penn-Reading Seashore Lines loses heavily on its operations. See *Penn-Reading Seashore Lines* v. *Public Utility Commission*, 5 N. J. 114, 74 A. 2d 265 (1950). Therefore, to include Penn-Reading in the Pennsylvania system would diminish the net railway operating income of the parent, and might, therefore, reduce the amount of franchise tax payable to New Jersey.

Another example of departure from a uniform application of the statute exists with respect to the system formed by the integrated operation of the Baltimore & Ohio, Reading and Central Railroad of New Jersey lines. The relationship between those three lines is very similar to the relationship between CNJ and CRP. The B. & O. does not own or operate any main line trackage beyond Philadelphia (Ex. CR-33). The main lines of the Reading within the State of New Jersey run only from the Delaware River at Trenton to Bound Brook Junction (Ex. CR-33). At that point, interchange is had with CNJ. Because the Reading owned a majority of the common stock of CNJ, and because B. & O. controlled Reading, CNJ has always been the preferred interchange carrier for Reading and B. & O. freight (Ex. CR-8, 234a-27 to 40). Through passenger service in B. & O. equipment is maintained from CNJ terminal in Jersey City via CNJ and Reading lines to Philadelphia, and thence via B. & O. to points south and west. The relationships between these three lines are a perfect example of companies whose properties are being operated as a single utility by virtue of stock control. Yet, these three lines have always been

treated as separate for franchise tax purposes, presumably because they maintain separate operating accounts and file separate Form A Reports with the Interstate Commerce Commission.

The foregoing data are extremely interesting when considered in the light of the professed intention of the taxing authorities and the Supreme Court of New Jersey to make *integrated transportation utilization* the criterion of whether affiliated roads shall be treated as a single system. The Long Island and the Pennsylvania make integrated utilization of their facilities for all freight hauling purposes. Similarly, Pennsylvania and the Penn-Reading Seashore are integrated under an operating agreement almost identical in its terms with the lease between CNJ and CRP. It is, therefore, evident that to construe the statute as requiring CNJ and CRP to be taxed as a system departs from uniform application of the professed criterion, and results in taxing appellant on an irrational and unequal basis.

As we have shown, it would clearly be to the State's disadvantage to include the Long Island and the Penn-Reading Seashore Lines in the system of the Pennsylvania Railroad. On the other hand, to tax CNJ and CRP as a single system means that the amount of tax payable to New Jersey will be increased. In other words, the amount of revenue to be derived rather than the fair import of the language has apparently controlled the judgment of the State officials in construing the statutory definition of a system for tax purposes. This necessarily results in unreasonable discrimination among identically situated carriers.

Such statutory interpretation violates the equal protection clause of the 14th Amendment. Equal protection means the right to taxation which is not only fair, but also based upon rational standards of classification. *Wheeling Steel Corp.* v. *Glander*, 337 U. S. 562 (1949); *Hartford*

Steam Boiler Insurance Co. v. *Harrison*, 301 U. S. 459 (1937). What is more, a party has standing to raise the question of equal protection without being required to show that the tax statute is incorrectly applied to him, and without being required to show that the tax assessed against him is unduly burdensome or confiscatory, as it is in this case. *Iowa Des Moines National Bank* v. *Bennett*, 284 U. S. 239 (1931); *Stewart Dry Goods Co.* v. *Lewis*, 294 U. S. 550, 561 (1935).

D. This Case Is Not Controlled by Any Earlier Decision Involving These Parties

The Supreme Court of New Jersey disposed of appellant's contentions in the following language:

> "The appellant says the statute as construed and applied by the Division of Tax Appeals violates the commerce clause and the equal protection and due process clauses of the 14th Amendment of the Federal Constitution. It made the same claim in its appeal from its 1946 franchise tax which we decided against the appellant in *Gardner, Trustee vs. Division of Tax Appeals*, 3 N. J. 27 (1949). An appeal was taken in that case to the United States Supreme Court, which was dismissed on the State's motion. *Central Railroad Company of New Jersey vs. Division of Tax Appeals*, 338 U. S. 946 (1950), 70 S. Ct. 488, 94 L. Ed. 583."

In so holding, the Supreme Court of New Jersey has fallen into error. In the 1949 case, appellant complained against the disallowance of certain items as a proper deduction from its net railway operating income. In the tax years there under consideration (1942-1946), the net railway operating incomes of both the New Jersey and Pennsylvania properties were consolidated for New Jersey franchise tax purposes, and this was quite correct, since during those years, no separate operating accounts were kept, nor was CPR even in existence at any time there

relevant. The taxes here involved were assessed after CPR had been set off from CNJ as a step in the reorganization of CNJ and with the approval of the bankruptcy court and the Interstate Commerce Commission as in the public interest. Appellant's principal claim in the 1949 case was that the New Jersey franchise tax was, in practical effect, a gross receipts tax, and that it was unconstitutional, even if fairly apportioned. This Court dismissed the appeal, presumably holding that *Central Greyhound Lines* v. *Mealey* had upheld the validity of an apportioned gross receipts tax upon transportation companies.

The issues in the present case are entirely different. Appellant here attacks the applicability of the apportionment formula in the face of accurately kept income and cost accounts which provide a sound basis for segregating the income of a unitary enterprise among the political subdivisions in which it operates, and also attacks the imposition of discriminatory taxation. In the earlier case, we complained against accounting techniques which were required by the Commissioner of Taxation prior to allocation. We did not attack the allocation itself. In the present case, the attack is on the State's very right to apply the allocation formula under circumstances in which it conclusively appears that New Jersey is actually assessing against CNJ 67% of every dollar earned by CRP in operation of an interstate railroad located wholly in Pennsylvania. The constitutional questions which are raised are entirely different.

Conclusion

For all of the foregoing reasons, petitioner-appellant respectfully suggests that the present case may be reviewed by this Court on direct appeal, and that the questions presented are substantial, meriting a plenary hearing.

JAMES D. CARPENTER,
Attorney for Petitioner-Appellant.

SCHEDULE A

SUPREME COURT OF NEW JERSEY, SEPTEMBER TERM, 1951

No. A 2

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, *Petitioner-Appellant,*

vs.

DIRECTOR, DIVISION OF TAX APPEALS OF DEPARTMENT OF TREASURY OF STATE OF NEW JERSEY, *Defendant-Respondent*

Argued September 10, 1951; decided October 1, 1951.

On appeal from the Division of Tax Appeals, Department of the Treasury of the State of New Jersey.

Mr. James D. Carpenter argued the cause for the appellant; Carpenter, Gilmore & Dwyer, attorneys; Mr. Judson C. McLester of the New York Bar and Mr. Milton A. Dauber on the brief.

Mr. Benjamin C. VanTine, Deputy Attorney-General, argued the cause for the respondent; Mr. Theodore D. Parsons, Attorney-General, attorney.

The opinion of the Court was delivered by

OLIPHANT, *J.:*

This is a railroad tax case which involves essentially the construction of R. S. 54:29A-2.

The appeals, which were taken to the Superior Court, Appellate Division, and certified here on our own motion, are from judgments of the Division of Tax Appeals, Department of the Treasury, which affirmed the franchise tax assessments against the Central Railroad of New Jersey made by the Director of the Division of Taxation for the tax years 1948, 1949 and 1950. The assessments were made pursuant to the provisions of the "railroad tax law of 1948", P. L. 1941, ch. 291, as amended by P. L. 1942, ch. 169, and further amended by P. L. 1948, ch. 40, R. S. 54:29A-1 et seq.

As was pointed out in *Norton* v. *State Board of Tax Appeals*, 134 N. J. L. 57 (E. & A. 1946), and again in *Delaware, Lackawanna & Western Railroad Co.* v. *Division of Tax Appeals*, 3 N. J. 27 (1949), the tax levied on railroad property had for years been continuously in litigation and such litigation still continues.

Previous to 1941 there was a straight property tax on Class I and Class III railroad property the proceeds of which are applied to uses of the State. That tax was computed upon the entire assessed valuation of such property at the average rate of taxation in the State for such year (R. S. 54:24-2). The average rate was upheld in *Central Railroad Co. of New Jersey* v. *State Tax Department*, 112 N. J. L. 5 (E. & A. 1933), certiorari denied 293 U. S. 568 (1934), 55 S. Ct. 79, 79 L. Ed. 667. In 1941 a new method of taxing such property was enacted, P. L. 1941, ch. 291, amended in 1942 by P. L. 1942, ch. 169, which in substance provided for a combination property and franchise tax computed in a given year on the basis of the net operating income of a railroad system for the preceding calendar year.

By the Constitution of 1947 it is provided that all real property assessed and taxed for allotment and payment to local taxing districts shall be taxed at the general tax rate of the taxing district in which the property is situate, Art. VIII, Sec. I, par. 1. It therefore became necessary to amend the railroad tax law to provide for a straight property tax at the local rate upon Class II railroad property. This entailed a substantial increase in such taxes and the Legislature amended the railroad tax law to provide drastic reductions in Class I (main stem) and Class III (tangible personal property) railroad property and in the franchise tax, P. L. 1948, ch. 40; R. S. 54:29A-23. This resulted in average total tax assessments for the years in question on Class I and Class III property of $452,541.34 and franchise taxes of $301,073.67. For those years the assessed value of that property averaged $42,144,192 and the percentage of the total combination property and franchise tax to property valuations for such years averaged 1.788%.

The appellant seeks by these appeals to have its franchise tax assessments reduced to the statutory minimum of

$4,000.00. In short it seeks to limit its combination property and franchise tax assessments to substantially the amounts assessed on its Class I and Class III property for the years in question.

If this appellant should be required to pay only the statutory minimum franchise tax of $4,000.00 per annum then the total average assessment for the years in question would constitute only 1.07% of its Class I and Class III property.

It must be remembered that the new method provided by the Legislature for taxing railroad property used in transportation service in this state was designed to give some measure of relief to the railroad companies in poor earning years and it gives the State an additional return in good earning years. *Delaware, Lackawanna & Western Railroad Co.* v. *Division of Tax Appeals*, supra. The record here shows conclusively that the years in question included "good earning years" under the formula devised in 1941.

As pointed out above the Class I and Class III property of appellant under the straight property tax law would have been subject to tax at the average rate of taxation. For the year 1948 this would have been 5.90%, for 1949—6.139%, and for 1950—6.201%. At such rates the tax would have been as follows, for 1948—$2,583,939, for 1949—$2,528,554, for 1950—$2,556,746.

It is quite obvious that the combined property and franchise tax as levied was but a fraction of the tax that would have been levied under the old straight property tax law upon Class I and Class III property. Since the record discloses a clear legislative intent to prevent the use of accounting practices which would allow further unintended deductions and since legislation must be accorded a rational interpretation consistent with its manifest purpose, *Grobart* v. *Grobart*, 5 N. J. 161 (1950), a construction should not be adopted that would lead to such further drastic reduction unless it can be shown the words of the statute clearly so require or the application of the recognized rule of construction leads to no other conclusion. Not only can this not be shown but, on the contrary, the language of the statute and the rules of statutory construction leads us to the conclusion that the Legislature never intended the construction urged here by the appellant.

We reaffirm what was said in the *Norton* and *Delaware, Lackawanna & Western* cases. The "railroad tax law of 1948" constitutes a new method of taxing property located in New Jersey and used in the furnishing of transportation service in this state. The law provides a combination property and franchise tax computed in a given year on the basis of the net operating income of a railroad system for the preceding calendar year. The justification for the tax is the presence in the state of Class I and Class III property of great value, which is essential to system operations. As a measure of the amount which must be paid in tax upon such property used on system operation, the Legislature has fixed a very low direct property tax to which has been added an additional amount to be determined by *the* results of such system operations, the total being far below the former straight property tax.

R. S. 54:29A-13 provides:

> "An annual franchise tax is hereby levied upon all railroads operating within this State, which shall be assessed at the rate of ten per centum (10%) upon the net railway operating income of the preceding year, computed and allocated in the manner hereinafter provided, of each system and of each railroad not part of a system, subject to the maximum and minimum provisions set forth in section 20 (c) hereof, L. 1941, c. 291, p. 777, § 13, as amended L. 1948, c. 40, p. 116, § 5."

The present dispute concerns what the Legislature meant by the word "system".

R. S. 54:29A-2 provides the following definition of the word "system":

> " 'System' means any independently operating railroad which operates its facilities and those of one or more other railroads as a single utility for furnishing transportation service. A system shall include all companies the property of which is so operated either by virtue of control through direct or indirect ownership of a majority or more of capital stock, or under lease, trackage rights or under any other form of contract,

and for which separate operating accounts are not maintained."

The different contentions of the parties are that the State says the Legislature was concerned with the actuality of the use of the properties of the appellant in New Jersey and Pennsylvania as a single utility for the furnishing of transportation service while the appellant maintains that, notwithstanding the properties may be used in such manner from the standpoint of physical operation, the legislative intention was to exclude a portion of an otherwise proven system because of the manner in which it keeps its accounts.

The railroad tax law also provides by section 11 that "Taxes assessed pursuant to this act shall be in lieu of all other State or local taxation of or measured by property taxable hereunder, other than assessments for benefits", and by section 12 "Property taxable under this act shall be assessed by the commissioner to each system and to each railroad not part of a system by which such property is used for railroad purposes. The assessment shall be made in the manner hereinafter provided."

The statute mentions only two situations; 1, a system operation and 2, an independently operating railroad which is not a part of a system. No provision is made for the levying of a tax on a part of a proved system.

The Lehigh Coal & Navigation Company, hereinafter referred to as the Coal Company owns and has at all times in question owned all of the lines of the appellant located in Pennsylvania except a very few miles of branch line. For many years prior to 1941 the appellant leased this property from the Coal Company and operated it as the Lehigh & Susquehanna division.

It is interesting to note that in 1942, the Trustees in reorganization of the appellant appealed its franchise tax assessments claiming that divisional accounts of the Lehigh & Susquehanna division were the separate operating accounts intended by the Legislature and that such accounts must be excluded in determining the franchise tax base upon which the franchise tax assessment was calculated. The State Board of Tax Appeals dismissed the appeal, *In re*

Pitney, 20 N. J. Misc. 448, 474 (1942), holding that the Legislature did not intend to limit the meaning of the first sentence of the definition as contained in R. S. 54:29A-2 by the second sentence thereof. The former Supreme Court granted certiorari but the appellant withdrew its appeal and similar appeals for 1943 and 1944 in December, 1945. *State v. State Board of Tax Appeals*, 134 N. J. L. 34 (Sup. Ct. 1946).

In 1939 a Mr. William Wyer made two studies of the properties of the appellant, particularly as to the operation of those in Pennsylvania one a segregation study whereunder revenues were apportioned to designate parts of the system and the other a severance or separation study which went into the question of what would happen if the New Jersey and Pennsylvania properties were actually operated separately. These studies showed large profits were being earned by the lines in Pennsylvania and large deficits were occurring from the lines in New Jersey and the plan to separate the lines was formulated. Mr. Wyer testified in this case that if there was actual separate operation of the lines in the two states there would be traffic shifts and that a substantial loss of income would result to both operations. He went on to say, with respect to the contemplated set-up, hereafter to be alluded to, "We didn't anticipate that the total revenue of the Central Railroad Company of New Jersey and the Central Railroad Company of Pennsylvania would be any different than the revenue formerly received by Central Railroad Company of New Jersey." From the very beginning it is apparent that any separate and independent operations envisaged by the "separation study" were not contemplated—that the plan never contemplated the arms' length bargaining of two separate and wholly independent operating companies.

In furtherance of the proposed plan for the separation of the line in Pennsylvania and New Jersey the name of a wholly owned subsidiary of the appellant, the Easton & Western Railroad Company, a Pennsylvania corporation, was changed to the Central Railroad Company of Pennsylvania hereinafter referred to as C. R. P., and the appellant began negotiations with the Coal Company regarding

the transfer of the leased properties in Pennsylvania to the C. R. P. In his studies Mr. Wyer spoke of the advisability of assigning the lease of the Coal Company properties, whereby the appellant would be relieved of all liability thereunder but he testified the appellant was not successful in this respect. On the contrary the agreement between the appellant and the Coal Company granting approval of the sublease relieves in no respect the liability of the appellant under the original lease, the appellant remains bound as heretofore. In addition, by that agreement the appellant has covenanted to maintain the continuity of its main line of railroad from the state line to the important New York terminal area. Also the agreement, to which the C. R. P. was not even a party, provides that there shall be only a single division of through rates between the Jersey Central Lines (appellant and C. R. P.) and connecting carriers which shall be further subdivided between appellant and C. R. P. according to a formula agreed upon by the appellant and the Coal Company. In short the arrangement with the Coal Company cannot be said to have contemplated separate operations. On the contrary the arrangement insofar as the furnishing of transportation is concerned, contemplated the continued operation of the Pennsylvania properties as part of the Jersey Central System as heretofore.

Thereafter the proposed form of agreement between the Coal Company and the Central Railroad Company of New Jersey, hereinafter referred to as C. N. J., and the sublease to the C. R. P. was prepared. This agreement also evinces a plan not to maintain separate operations of two truly independent operating railroads. The provision for the maintenance of depreciation accounts and those for the payment of per diem car hire by the C. N. J. on its own equipment are but two factors showing that true separate and independent operation by the two companies was never contemplated.

The United States District Court, on petition of the appellant, approved the sublease of the Pennsylvania lines of the appellant to C. R. P., the making of the agreement with the Coal Company, which among other things fixed the

division to be received by C. R. P., and the establishing of C. R. P. as an operating company, subject to the further approval of the Interstate Commerce Commission. That commission found that the "sublease of the lines in Pennsylvania from the trustees to the applicant (C. N. J. to C. R. P.) would result in no change in train service. * * * The trains would operate just as they do today * * *;" and that, with respect to the important coal movements, the great part of which come into the State of New Jersey "the system function of the facilities would be precisely the same whether the movement in Pennsylvania to the Delaware River were begun and carried on in the name of the trustees (C. N. J.) or in the name of the applicant" (C. R. P.).

Concerning the proposed accounting the Interstate Commerce Commission report said:

> "One of the benefits claimed for the proposals herein is that the trustees will not have to carry two separate sets of accounts, yet the trustees and the applicant (C. R. P.) would have separate books."

Thus the evidence is persuasive that even before any purported separate operations were undertaken from the standpoint of furnishing transportation service the appellant always intended to operate the Pennsylvania properties exactly as such properties were then being operated as the Lehigh & Susquehanna Division of the C. N. J.

The alleged separate operation of the two companies began on August 5, 1946. On that day all foreign lines were notified that all settlements with "Jersey Central Lines" would be subdivided between C. R. P. and C. N. J. according to a table. All division agreements continued to be those of a single entity, the "Jersey Central Lines." The two companies were known and advertised as a single operating entity, the "Jersey Central Lines." The Division of Tax Appeals pointed out below that:

> "One of the appellant's own witnesses who testified that he originated the term, stated that it embraced 'all of the railroad companies operated or controlled' by C. N. J. Another witness stated that Jersey Cen-

tral Lines, and we quote, 'is more or less in the nature of a trade name, which identified * * * the Central Railroad Company of New Jersey and the various railroads that form part * * * of the system'. The record goes so far as to reveal the rather small detail that even the telephone number of C. N. J. may be found under the listing 'Jersey Central Lines'. Additionally, form cards interchanged with foreign roads relating to car interchange were headed by the same general description."

The record discloses that what the Interstate Commerce Commission foresaw in fact materialized—that train service upon the lines is run in exactly the same manner as when the lines of the present C. R. P. were the Lehigh & Susquehanna Division of the C. N. J. and we agree with the Division of Tax Appeals that the record leaves no doubt as to the manner in which the properties are operated. The proof is clear and convincing that the appellant operates its Class I and Class III property in New Jersey and the leased property of the Coal Company as a single entity for the furnishing of transportation services. Thus the appellant operates the properties in Pennsylvania as a part of a system within the meaning of the first sentence of the statutory definition.

The appellant argues that the operating accounts proviso the second sentence of the definition was intended to exclude a railroad which otherwise would constitute a part of a system. With this we cannot agree. As stated, the purpose of the act was to provide a combination tax in lieu or substitution of a straight property tax predicated upon the use of property in this State. If the plan or device used by this appellant can be permitted then the very purpose sought to be attained by the act can be destroyed at the will of the tax paying railroads. That this could not have been the legislative intent is shown by Exhibit CR-4 the "Report on Railroad Taxation" by the Joint Legislative Committee made in 1941 in which appears the following "In considering and drafting the franchise formula every precaution has been taken to render it as nearly impossible of evasion

as it could be" and "Because of the suggested reduction in rates at which railroad property is liable to taxation, the Committee does not feel justified in recommending any alterations resulting in further reductions in future tax liability."

It is a cardinal rule of statutory construction that legislation should be construed so that, if possible, full force and effect shall be given every sentence, clause and word thereof. *Steel* v. *Freeholders of Passaic*, 89 N.J.L. 609 (E.&A. 1916); *Bogert* v. *Hackensack Water Co.*, 101 N.J.L. 518 (E.&A. 1925); *Oldfield* v. *New Jersey Realty Co.*, 1 N.J. 63 (1948).

The construction claimed by the appellant would result in a tax upon a part of a system. As pointed out above the statute provides for a tax to be assessed to each system and to each railroad not part of a system. R.S.54:29A-12. A franchise tax is also levied upon the net operating income of the preceding year of each system and each railroad not part of a system. R.S.54:29A-13. There is no provision in the law for the taxing of part of a system. There was no legislative intention to exclude any part of a system by the second sentence of the definition. Thus only can full force and effect be given to every sentence, clause and word of the railroad tax law as required by the rule of the *Bogert*, *Steel* and *Oldfield* cases, *supra*.

As stated appellant argues that the second sentence of the definition was intended to exclude a company in the position of the Central Railroad, although otherwise it might be held to be a part of its system. The intention of the Legislature as expressed in a statute should be ascertained and given effect. *Norton* v. *State Board*, *supra*. The words "for which" obviously refer to the clause "all companies the property of which is so operated." In the instant case this means the Lehigh Coal & Navigation Company whose property is operated by the Jersey Central Lines. There is nothing in the record or the legislative history of this legislation to support the premise that this portion of the definition was intended to include a situation where a taxpayer would operate its own property through a wholly owned subsidiary and thereby escape tax liability.

No limitation or exclusion was intended by the second

sentence of the definition. If it was intended to narrow or limit the broad language of the first sentence or exclude any part of a proved system, then inept language was used for that purpose. As was said in *State of New Jersey* v. *Rosecliff Realty Co.*, 1 N.J. Super 94 (App. Div. 1948) "The verb 'include' has not been defined so as to give it such a restrictive meaning." See also *Baker* v. *Soltau*, 94 N.J. Eq. 544 (E.&A. 1923) and *Snegon* v. *Consolidated etc. Ins. Co.*, 117 N.J. Eq. 325 (Ch. 1934).

Also the word "separate", as it refers to operating accounts, does not, in our judgment, have the meaning attributed to it by the appellant—that it refers to accounts covering operations which, while unified in fact, are technically separate. "*Separate*" means individual, disconnected, divided, not united or associated. Black's Law Dictionary; Webster's New International Dictionary, 2nd Edition. The accounts in question are neither individual nor disconnected, they reflect the single result of a single unified operation. We reach this conclusion from the record of actual operations as well as the finding of the Interstate Commerce Commission that the appellant "will not have to carry two separate sets of accounts yet the trustees and the applicant (C.R.P.) would have separate books." Also in actual operation some of the books, such as car hire books, were not kept separately but kept together just as any other system operation.

The true meaning of any clause or provision of a statute ordinarily is that which best comports with the subject and general object of the statute. *Maritime Petroleum Corp.* v. *City of Jersey City*, 1 N.J. 287 (1949). It would seem just ordinary common sense that, if there be in fact a single system operation, there could be but a single set of operating accounts for such single operation, no matter how many sets of books or divisional accounts might be kept. Such was the legislative intent, the whole definition must be read together. If an independently operating company actually operates its own facilities and those of one or more other companies as a single entity for furnishing transportation services, then the latter company or companies is or are a part of the system. No exclusion was intended by the latter part of the second sentence. That

clause was intended to assure that there would not be included, because of the manner of control, any railroad which on its own part is a truly separate and independent railroad from the standpoint of furnishing transportation service. The clause means the separate operating accounts of a railroad which is truly separate and independent from the standpoint of furnishing transportation service.

With particular reference to the instant case we also find that the C.R.P. is in all things save its intangible and unsubstantial corporate entity the C.N.J. The stock ownership of C.R.P. is one hundred per cent in C.N.J. Under such circumstances even the books of the C.R.P. are not separate books but those of this appellant, the C.R.P. being a mere alter ego of the C.N.J. *Stockton* v. *Central Railroad Co. of New Jersey*, 50 N.J. Eq. 52 (Ch. 1892).

As we pointed out in *Delaware, Lackawanna & Western R.R. Co.* v. *Division of Tax Appeals, supra*, "It was the legislative purpose to have the state share with the railroad companies in good earning years and the purpose is only accomplished if we determine the true net operating income (for each system) for each respective accounting period." The definition in question was intended to be of aid to the Division of Taxation in the accomplishment of that objective. It was not intended as a means of defeating such purpose. It is apparent that, if the appellant were to prevail on this appeal, there will henceforth never be any "good earning years" for it insofar as the State of New Jersey is concerned from a tax revenue standpoint.

Since the new method of taxing railroad property was adopted in 1941 the state taxing authorities have consistently interpreted the statute as not intending any limitation by the second sentence of the definition. When the amendment of 1948 was adopted the language in question was left exactly the same. The State contends that the appellant is estopped to deny the interpretation given to the language of the statute by the State Tax Commissioner because of certain representations made on behalf of appellant when the 1948 amendments were before the Legislature. We need not decide this point but such facts are persuasive that when the Legislature had the matter before it in 1948 it was fully aware of the administrative con-

struction and was in accord that such was the correct interpretation of the law. *Ford Motor Co.* v. *New Jersey Dept. of Labor & Industry*, 7 N.J. Super 30 (App. Div. 1950); 2 Sutherland Statutory Construction, par. 5105 (3rd Ed. 1949). Also in the *Norton* case, *supra*, the Court pointed out that the Director was given broad power to assure that the true net operating income would be determined. We held in the *Delaware, Lackawanna & Western* case, *supra*, when the Legislature amended the railroad tax law of 1948, that it must be assumed it acted with this judicial construction in mind.

The appellant says the statute as construed and applied by the Division of Tax Appeals violates the commerce clause and the equal protection and due process clauses of the 14th Amendment of the Federal Constitution. It made the same claim in its appeal from its 1946 franchise tax which we decided against the appellant in *Gardner, Trustee* v. *Division of Tax Appeals*, 3 N.J. 27 (1949). An appeal was taken in that case to the United States Supreme Court, which was dismissed on the State's motion. *Central Railroad Company of New Jersey* v. *Division of Tax Appeals*, 338 U.S. 946 (1950), 70 S.Ct. 488, 94 L.Ed. 583.

Appellant has placed great reliance in its argument that the statute violates the commerce clause of the Federal Constitution upon *Spector Motor Service* v. *O'Connor*, 95 L. Ed. Adv. Ops. 435 (April 9, 1951). This case dealt with the imposition of a State tax "upon the privilege of carrying on a business that was *exclusively* interstate in character." In the case before us the appellant maintains Class I and Class III properties in this State in connection with the furnishing of both intrastate and interstate commerce. The Supreme Court held in the *Spector* case that the State is not precluded from imposing taxes upon other activities or aspects of a business which, unlike the privilege of doing interstate business, was subject to the sovereign power of the State, and that those taxes may come out of funds derived from a taxpayer's interstate business, provided the burden is reasonably related to the powers of the State and non-discriminatory. Nothing contained in this opinion gives even color of support to the contention of the appellant. On the contrary our examination of it supports the

constitutionality of the combination tax under review. The Supreme Court carefully pointed out that its conclusion was not in conflict with *Central Greyhound Lines, Inc.* v. *Mealey*, 334 U.S. 653 (1947), 68 S.Ct. 1260, 92 L.Ed. 1633, a case cited by that court in its *per curiam* opinion dismissing the appeal of the appellant from a franchise tax assessment wherein similar Federal constitutional questions were raised. *Central Railroad Company of New Jersey* v. *Division of Tax Appeals, supra.*

The judgments are affirmed.

A true copy
CHARLES K. BARTON,
Clerk

Filed

Oct. 1, 1951

CHARLES K. BARTON
Clerk

SCHEDULE B

PERTINENT SECTIONS OF P.L. 1948, CHAPTER 40

2. Definitions. As used in this act, unless the context clearly requires a different meaning:

"Railroad" means any common carrier by railroad engaged in, owning or constructing facilities for, the transportation of persons or property in or through this State, other than a street railway or traction company using or occupying the public streets, highways, roads or other public places, the taxation of which is otherwise provided by law.

"System" means any independently operating railroad which operates its facilities and those of one or more other railroads as a single utility for furnishing transportation service. A system shall include all companies the property of which is so operated either by virtue of control through direct or indirect ownership of a majority or more of capital stock, or under lease, trackage rights or under any other form of contract, and for which separate operating accounts are not maintained.

N.J.S.A. 54:29A-2

* * *

13. Franchise excise. An annual franchise tax is hereby levied upon all railroads operating within this State, which shall be assessed at the rate of ten per centum (10%) upon the net railway operating income of the preceding year, computed and allocated in the manner hereinafter provided, of each system and of each railroad not part of a system, subject to the maximum and minimum provisions set forth in section 20(c) hereof.

N.J.S.A. 54:29A-13

* * *

14. Measure of franchise tax. For the purpose of this article, net railway operating income shall be computed as total railway operating revenues from all sources, including any revenue whatever derived directly or indirectly from property which is used for railroad purposes, less costs of railroad maintenance, operation, depreciation and amortiza-

tion, railway tax accruals, uncollectible railway revenues, rentals (both debits and credits) for equipment leased for less than one year or interchanged, and joint facility rents (both debits and credits). Deductions from operating revenues for depreciation, additions and betterments, and compensation for personal services shall be subject to regulation by the commissioner, as to reasonableness of amount and appropriateness of accounting distribution.

Depreciation and amortization charges shall in no instance, however, exceed the amounts permitted by the Interstate Commerce Commission in determining the net railway operating income of the railroad for the year under consideration.

For the purpose of determining the measure of the tax imposed by this act, net railway operating income of each system, and of each railroad not part of a system, shall be allocated to this State in the proportion that the number of miles of all track over which the railroad or system operates in this State bears to the total number of miles of all track over which it operates.

N.J.S.A. 54:29A-14

(9400)